

# Governor's Review

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I am pleased to present the SBP Performance Review for FY18, during which the economy showed substantial improvement despite challenges related to external vulnerabilities. Pakistan achieved a thirteen year high GDP growth rate of 5.8 percent on account of robust performances by industrial and agricultural sectors which grew by 5.8 percent and 3.8 percent respectively. Similarly, services sector registered a growth of 6.4 percent. Average CPI remained within manageable levels i.e., at 3.9 percent vis-a-vis the target of 6 percent. The investment to GDP ratio improved to 16.4 percent due to higher credit off take in the backdrop of low interest rates and maturity of fixed investments in last few years. The external sector remained under stress primarily due to trade imbalances despite some improvement in exports and worker's remittances over the preceding period.

The Monetary Policy Committee (MPC), established under the SBP Act, 1956 cautiously pursued accommodative policy stance in H1-FY18 and maintained a policy rate of 5.75 percent mainly due to favorable macroeconomic conditions. However, external sector pressures such as widening current account deficit, currency depreciation as well as overheating of the economy amidst a buildup of demand pressures, raised the need to tighten the policy stance to ensure growth and stability in medium to long term. Consequently, the MPC decided to raise the policy rate to 6.50 percent at the end of FY18.

On the external front, the current account deficit increased to USD 18.1 billion due to strong growth in imports. However, double digit growth in exports and a modest recovery in workers' remittances could not cover the rising import bill. This led to a decrease in SBP's foreign exchange reserves by USD 6.4 billion to reach USD 9.8 billion by end June 2018. The higher current account deficit was mainly due to the trade deficit, which grew by 16.5 percent to USD 31.1 billion. Higher import payments were primarily due to an increase in energy prices, rising industrial activities, enhanced power generation, infrastructure development and capacity expansions. Net capital and financial inflows were recorded at USD 12.4 billion during FY18. Major inflows included issuance of Eurobonds and Sukuk, commercial borrowings and loans from multilateral and bilateral sources.

Considering the global developments, SBP increased its funds allocation in short term US treasuries, which proved beneficial as yields improved. SBP also continued with its policy of investment diversification to include higher yielding instruments as well as continuing investment in Islamic Sukuk without increasing the investment risk.

SBP being cognizant of its role for ensuring financial stability for the economic well-being of Pakistan, has established a Financial Stability Executive Committee to proactively review related issues. In the same vein, SBP and Securities & Exchange Commission of Pakistan established a Council of Regulators to ensure financial stability and address systemic risks particularly emanating from cross market implications. The Council in its last meeting deliberated on the establishment of a Joint Task force on financial conglomerates to respond effectively to systemic risks. SBP has reviewed the current supervisory regime in line with the existing legal mandate and best practices, to institutionalize a consolidated supervision framework. Further, in the wake of changing market dynamics and technological advancements, a Roadmap 2025 for banking industry is also under consideration.

Framework for the identification of a Domestic Systematically Important Banks (D-SIBs) was introduced to address negative externalities created by such institutions. Banks designated as D-SIBs would be subject to enhanced supervisory requirements. SBP also launched a Systemic Risk Survey to assess and quantify risk perceptions of market shareholders in line with international best practices to strengthen the regulatory regime.

SBP is progressively advancing towards the implementation of a Risk Based Supervision (RBS) Framework as a forward looking approach to strengthen its supervisory role. The project would help SBP in structured risk profiling of financial institutions, prioritizing scarce supervisory resources and articulating responses to financial stress. The architecture of the RBS framework was developed in-house and the Toronto Centre for Global Leadership in Financial Supervision is helping SBP for capacity building of supervisory resources to finalize components of the framework. Thematic inspections are undertaken to evaluate risks and controls across the industry based on RBS approach for ensuring corrective measures and policy initiatives. Accordingly, inspections were carried out to ensure compliance with SBP instructions to assess the governance frameworks of banks.

On the regulatory front, SBP issued guidelines on Compliance Risk to provide banking industry a uniform and systematic approach for identification, assessment and management of compliance risks. The guidelines aim to promote a 'compliance culture' in banks and strengthen the effectiveness of the compliance function by adopting a structured and risk focused approach. Consumer satisfaction/confidence is fundamental to the stability of banking sector. Given the potentially large costs and possible consequences for financial stability, SBP has issued guidelines on Prohibited Banking Conduct to strengthen the Fair Treatment of Customers regime and promote responsible business conduct.

SBP has been actively pursuing measures to prevent banking channels from being used for money laundering and terrorist financing. Anti-Money Laundering and Combating Financing of Terrorism Regulations have been aligned with Financial Action Task Force recommendations. Pakistan's National Risk Assessment (NRA) was undertaken in collaboration with all government stakeholders to identify and understand Money Laundering and Terrorist Financing risks in the country and follow a risk based approach to mitigate the same. Based on the findings of NRA, revised regulatory instructions have been issued. Further, SBP continued its cooperation with the Government of Pakistan for effective implementation of the National Action Plan and took measures to freeze bank accounts of individuals listed on the fourth schedule of the Anti-Terrorism Act as well as UNSC Resolutions.

In order to address challenges relating to low level of financial inclusion, SBP developed a broad National Financial Inclusion Strategy (NFIS). SBP undertook various initiatives under the NFIS including schemes of Asaan Mobile Accounts and Asaan Accounts, Extension of Digital Credit and the launch of Financial Literacy Program for enhancing financial inclusion. Results of the same are encouraging since the number of Branchless Banking accounts reached 39.2 million with 43.6 percent growth in FY18. It is pertinent to mention that the recently published World Bank Group - Global Findex Report 2017 showed that account holders in Pakistan have grown from 13 percent to 21 percent of the adult population over a period of two years.

Considering the importance of agriculture sector in Pakistan's economy and being vital component of SBP's financial inclusion strategy, necessary support was provided to the sector. Encouragingly, strong growth momentum was recorded during FY18 as disbursements grew by 38 percent to reach Rs 972.6 billion. In terms of outreach, 450,000 new borrowers were provided agriculture-finance

during FY18 which increased their number to 3.7 million. SBP, being cognizant of the important role played by SMEs in economic development and employment generation, announced ‘Policy for Promotion of SME Financing’ in 2017. It is projected that effective implementation of the said policy would enhance share of SME financing to 17 percent by the end of 2020.

SBP’s contribution towards the promotion of Islamic Banking has been recognized globally. SBP was voted as the best central bank in a poll conducted by Islamic Finance News, Malaysia. During FY18, SBP issued ‘Guidelines for Conversion of a Conventional to an Islamic Bank’ to facilitate the process of conversion. Islamic Banking Institutions were also advised to enhance their training and capacity building measures for continuous development of the industry. Similarly, SBP also took capacity building initiatives for religious scholars to broaden their talent pool and officials of banks to create awareness and enhance their skills mix. The Islamic Banking Industry (IBI) continued its growth momentum in all areas during FY18. Assets and deposits of the IBI increased to Rs 2,482 billion and Rs 2,033 billion with substantial annual growth of 22 percent and 18.2 percent respectively at the end of June 2018.

Being cognizant of the importance of a robust payment system, the SBP acted proactively over the years to develop a secure, affordable and accessible payment landscape in Pakistan. SBP and Bill & Melinda Gates Foundation signed an agreement for the establishment of a Micro Payment Gateway under the National Payment Gateway Program for promoting access to digital financial services to the poor. On the regulatory front, SBP issued Electronic Fund Transfers Regulations, a Payment Systems Designation Framework, New PRISM Operating Rules and Guidelines on White Label ATM Operators to strengthen the overall supervisory regime. SBP in collaboration with FBR and 1-Link successfully developed and implemented the mechanism for collection of FBR duties and taxes through Alternate Delivery Channels (ADCs). The online tax collection system provides end-to-end solutions for filing of tax returns, payment of taxes, settlement with SBP and subsequent recording and reconciliation with the Government treasury in an automated environment. This facility will also be made available for provincial governments enabling them to collect their taxes and duties through ADCs.

SBP is also working with AGPR and CGA to shift from existing cheque based payments to Direct Credit System (DCS) under the World Bank Group funded project titled ‘Public Financial Management and Accountability’. In the first phase, the salaries and pension of federal government employees will be shifted to DCS, wherein the funds will be credited to the beneficiary accounts in real-time upon receipt of electronic instructions from AGPR.

Despite the introduction of the above mentioned e-payment solutions, cash remains a dominant mode of payment. In this context, the SBP Vision 2020 has envisioned availability of clean and good quality banknotes with state of the art security features. In this pursuit, the Bank initiatives included the implementation of the Currency Management Strategy, introduction of latest security features in banknotes and exploring innovative techniques to improve the quality and durability of bank notes.

SBP is investing heavily in its HR at all levels in line with the SBP Vision 2020 to enhance skills mix of its staff to meet diverse organizational goals. Extensive trainings in multiple areas including functional, managerial and leadership tracks were provided to over 1000 officers in reputed institutions. Similarly, over 200 officers were sent on foreign courses in FY18 to equip them with the best global practices.

IT remained a priority area under the SBP Vision 2020. SBP upgraded its core banking system Globus to the latest release of Temenos T24. Apart from new business functionalities available in T24,

additional benefits in terms of increased system performance and enhanced security capability have also been realized. The year witnessed major improvements in the area of information and cybersecurity governance within the Bank.

To provide full independence, a new Office of the Chief Information Security Officer (OCISO) was established along with appointment of CISO. Organization-wide IT Security Policy covering the complete IT infrastructure of SBP and its subsidiaries was devised. OCISO led the efforts in conducting the first annual SWIFT Customer Security Control Framework and reviewed SBP's SWIFT security posture. Similarly, OCISO performed multiple Software Vulnerability Assessments in IT Infrastructure to identify security vulnerabilities in software systems used in SBP. The Business Continuity Management function at SBP provided support to all critical/ support departments through well equipped backup sites to handle crisis situations. Similarly, a state of the art Disaster Recovery site is functioning as a backup for critical applications and data. Business Continuity exercises are regularly undertaken to test and enhance the level of readiness of critical functions in case of need.

SBP implemented an Enterprise Risk Management Framework in 2017. The Bank engaged services of the specialist trainers to identify strategic risks through a top down approach to compare the output against the risk inventory developed through a bottom up approach. Capacity building sessions were arranged in the areas of risk appetite framework, key risk indicators and dashboard applications to provide exposure to middle and senior management for effective implementation of the framework. The Bank has also taken a proactive approach to meet minimum requirements of IFRS 9 compliance process. The Bank has completed a project that laid the foundation for the development of Expected Credit Loss Models for reserve management portfolios as per requirements of the IFRS 9 standard.

SBP Banking Services Corporation and Pakistan Security Printing Corporation continued to provide related services to all stakeholders. Deposit Protection Corporation which was established to secure interests of depositors has commenced its operations on June 01, 2018.

Lastly, I would like to express my gratitude to the SBP Board of Directors for their unwavering support to enable us to achieve important milestones/ strategic goals. I also extend my appreciation to SBP staff for their concerted efforts to ensure the smooth and effective functioning of the Bank.

**Tariq Bajwa**  
Governor/Chairman

October 30, 2018